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SIPDIS

STATE FOR WHA/BSC, WHA/EPSC  
STATE PASS TO USTR FOR LYANG, MSULLIVAN  
USAID FOR AA/LAC ADOLFO FRANCO  
TREASURY FOR OSIA MAUREEN WAFER  
TREASURY FOR OTA RICHARD BARTHOLOMEW  
COMMERCE ITA SARAH COOK  
NSC FOR MIKE DEMPSEY, SUE CRONIN  
SOUTHCOM FOR POLAD  
US SOUTHERN COMMAND MIAMI, FLORIDA

SENSITIVE

E.O. 12958: N/A  
TAGS: [ECON](#) [EFIN](#) [ETRD](#) [PA](#)  
SUBJECT: PARAGUAY'S 2006 BUDGET PROPOSAL, PUBLIC BANK LAW  
AND TOURISM LAW

**¶11.** (U) This cable is Sensitive but Unclassified. Please protect accordingly.

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Summary  
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**¶12.** (SBU) Paraguay's 2006 budget proposal, recently submitted to Congress, projects a fiscal deficit of 0.66% of GDP, with 2006 real GDP growth of 3.5 percent (vice 3.25 percent for 2005) and inflation of 6 percent plus or minus 2 percent (the same target as for 2005). Minister Bergen told the Ambassador that he would execute the budget to aim for a zero deficit in 2006, and that the budget proposal was developed with greater interagency coordination than in past years. The Ambassador flagged our concern with the tourism law making its way through Congress that includes a mandated six percent commission for travel agents on airline ticket sales. Bergen shares our concerns, but expressed doubt that the provision would be vetoed. The Ambassador also noted the problems embodied in the first tier public bank bill passed by both houses of Congress. Bergen agreed and was hopeful that the President would veto the bill when it reaches his desk. End Summary.

**¶13.** (SBU) In a meeting to request budget related technical assistance (SEPTEL), the Ambassador and Finance Minister Bergen discussed the GOP's 2006 budget, the draft tourism law and the first tier public bank law. Vice Minister of Economy Jorge von Horoch and Econchief also attended the meeting.

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GOP's 2006 BUDGET PROPOSAL  
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**¶14.** (U) Minister Bergen described the GOP's 2006 budget proposal, submitted to Congress in late August, as a serious budget developed with significant interagency consultation, including with input from the President and Vice President. The budget projects a fiscal deficit of 0.66% of GDP, with 2006 real GDP growth of 3.5 percent (vice 3.25 percent for 2005) and inflation of 6 percent plus or minus 2 percent (the same target as for 2005). The proposed budget calls for a level of spending approximately equal to the level of spending approved by Congress for 2005.

**¶15.** (SBU) Actual execution of the 2005 budget will be lower than the level approved by Congress last year, when Congress boosted proposed spending by 8 percent over that proposed by the executive, which, if executed, would have resulted in a budget deficit of about 2.5 percent of GDP. The Ministry, through under-execution, is aiming for a balanced result for 2005, and will aim for balance in 2006 as well, according to Bergen. In 2002 through 2004, Congress passed a budget slightly lower than that proposed by the Executive. Bergen expressed hope that the conscious effort by the Ministry of Finance to develop the budget in close consultation with other ministries would reduce the amount of direct lobbying of Congress typically done by other Ministers.

**¶16.** (U) The administration's official message to Congress submitted with the 2006 proposal notes that 2004 central government revenues were up 34.1 percent over 2003 and 70 percent over 2002, the year of Paraguay's worst recent recession. Through the first half of 2005, central government revenues were up 15.7% over the same period in **¶12004**. The message also notes that current spending has risen slowly, but that capital spending has increased more rapidly.

**¶17.** (SBU) The Ambassador asked Minister Bergen about how all the increased revenue collections of the past two years have

been spent. Bergen pointed to increased debt service (including external and the small amount of internal debt), which is projected to be \$293 million in 2006, a 77 percent increase over the amount of debt service in 2002. Also, the budgets of the electoral commission and the judiciary, as well as the amount of money going to political parties, have increased significantly.

¶18. (SBU) The 2006 budget has an increased emphasis on social spending and real investment. Actual execution of amounts budgeted for GOP investment in the past few years has been about fifty percent. This year, the Ministry spent time discussing investment projects with project managers to get a better handle on actual capacities, and the Minister believes the 2006 budget proposal is more realistic with respect to government investment. Bergen said that, working with President Duarte and within the Economic Cabinet, approximately \$130 million of investment proposals submitted by other ministries was not included in the budget proposal.

¶19. (SBU) Treasury's Resident Budget Advisor believes that the 2006 budget proposal is an improvement over past budgets because it does include more realistic spending proposals and was developed with greater inter-ministerial collaboration that included a more conscious effort to coordinate broad spending priorities. However, the budgeting process remains more focused on quantities of expenditures than on the effectiveness of goods and services to be purchased.

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TOURISM LAW WITH MANDATED COMMISSIONS  
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¶10. (SBU) The Ambassador flagged our concern with the tourism law making its way through Congress that includes a mandated six percent commission for travel agents on airline ticket sales. American Airlines has told us that it will consider abandoning the market on principle should the bill become law. The law has passed both houses of Congress and is with the Senate for consideration of the two versions, both of which include the commission. Detractors argue that the law is a setback for Paraguay's business climate and runs counter to efforts to promote more civil aviation as evidenced by the GOP's signing of Open Skies agreements with the US, Chile and Panama. Many members of Congress, though, have connections with travel agencies.

¶11. (SBU) The Ambassador told Bergen that mandating the commission level would send a bad signal for the business climate and could lead to the exit of American Airlines (which provides the only wide-body service to Paraguay, with its accompanying larger cargo capacity). Bergen said that he completely agreed that the provision was a bad idea, and that he had spoken about it with President Duarte and the President's Economic Advisor Carlos Walde. He cautioned, though, that with a number of Congressional members having relatives in the travel agency business, he thought that Congress may have the two third's majority necessary to overcome a Presidential veto, should one be forthcoming.

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FIRST-TIER PUBLIC BANK LAW  
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¶12. (SBU) The Ambassador also noted the problems embodied in the first tier public bank bill passed by both houses of Congress, each with its own set of changes to the original version that weaken the law to the point where it may be worse than the current situation. The bill is currently with the Senate, which must either reaffirm its version, or vote to accept the Lower House version. President Duarte has stated publicly that he will consider a veto of the bill.

¶13. (SBU) Minister Bergen acknowledged that the Senate version was unacceptable. While the bill was still under consideration by the lower house, the Executive branch made a strong effort to convince leaders to pass the executive's version, to include the President hosting an event at his residence with Colorado deputies. At the last minute, though, the deal fell through and the lower house passed a version that would give extraordinarily generous benefits to employees of the bank dismissed as part of the reform. Bergen noted that if turned into law, it would set a bad precedent affecting future reforms. Bergen supports a Presidential veto of the legislation.

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COMMENT  
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¶14. (SBU) The failure of the President to prevail in the Lower House on the public bank law demonstrates the limits to his ability to get what he wants legislatively, despite the new coalition that increased Colorado Party control of

the Congress. The President at times has to face resistance to reforms from within his own party. While it's difficult to know just how hard the President pushed for the law, Bergen's comments and the President's subsequent public statements about vetoing the law suggest that he did lobby for the executive's version. For Paraguay's future development, the reform of the first tier public bank is more important than mandated airline ticket commissions, and a veto of the first bill is more likely than the latter. The continued commitment to fiscal restraint evident in the new budget and Minister Bergen's comments is reassuring. It also adds to the evidence that concerns of some observers that Minister Borda's departure in May would lead to fiscal profligacy were overblown.

KEANE